

**VIRGINIA RACING COMMISSION**

**REPORT ON AUDIT  
FOR THE YEAR ENDED  
JUNE 30, 2007**



## **AUDIT SUMMARY**

Our audit of the Virginia Racing Commission for the year ended June 30, 2007, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System; and
- a matter involving internal control and its operation and compliance with applicable laws and regulations that we have communicated to management in the Comments to Management section of this report.

We recommend that the Commission update its information security program to comply with the Commonwealth's standards. The Commission has taken a number of actions to address the issues that we reported in our previous report related to its information security program and has made progress towards complying with the Commonwealth's standards. However, the Commission's security program continues to lack some of the components necessary to comply with the Commonwealth's security standard.

### **Risk Alert and Efficiency Issue**

During the course of our audits, we encounter issues that are beyond the corrective action of management and require the action of either another agency or outside party or a change in the method by which the Commonwealth conducts its operations. We feel that these practices or conditions represent a risk to the Commonwealth.

We review the agreements between smaller agencies, which do not have sufficient resources or staff, and larger agencies, which provide accounting, budgeting, personnel, or information security resources. We have found circumstances where these arrangements are not providing or improving internal controls. In some circumstances, we have found that the arrangement may contribute to actually weakening internal controls. The Secretaries of Administration, Finance, and Technology should work with the Departments of Accounts, General Services, Planning and Budget, and Human Resource Management, and the Virginia Information Technologies Agency to develop and implement an administrative agreement for all back office operations. This agreement should include outside managerial oversight and internal controls for agencies requiring administrative assistance or the Secretaries should establish a back office operation to provide these functions. We discuss this recommendation in greater detail within the section entitled, "Comments to Management". We believe that the Racing Commission would be an ideal candidate for outsourcing the entire administrative function.

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## **COMMENTS TO MANAGEMENT**

### **RISK ALERT AND EFFICIENCY ISSUE**

During the course of our audits, we encounter issues that are beyond the corrective action of management and require the action of either another agency or outside party or a change in the method by which the Commonwealth conducts its operations. We feel that these practices or conditions represent a risk to the Commonwealth.

#### Improve Service Arrangements between Agencies

The Auditor of Public Accounts has advocated that smaller agencies, which do not have the resources or staff, use larger agencies for business functions, such as, accounting, budgeting, information security, or personnel resources. These arrangements allow the smaller agencies to concentrate on providing program services and eliminate unnecessary personnel costs and resources dedicated to administrative functions.

During an audit, we review the arrangements between agencies and the internal controls surrounding financial transactions, payroll, fringe benefits, and information security. We have found circumstances where these arrangements are not providing or improving internal controls. In some circumstances, we have found that the arrangement may contribute to actually weakening internal controls.

Smaller agencies do not have the staff expertise or resources to process financial transactions, personnel and payroll, procurement, and other administrative processes, such as implementing an adequate information security program, and maintaining adequate separation of functions for basic internal controls. Loss of one person can, and does in many of these agencies, compromise the internal control structure and knowledge base needed to handle key transactions and duties. Therefore, the use of larger agencies with sufficient staff and resources provides needed internal controls and management oversight of public resources.

Further, change in agency leadership may result in having leaders without knowledge of state processes, standards, regulations, and laws. Agency leadership without an understanding of this essential information could enter into agreements or contracts that are not in the best interest of the agency or the Commonwealth.

In many cases, the service arrangements are ad hoc agreements to provide services where neither the service provider nor the agencies have a clear understanding of what they need. The intended purpose of these arrangements is to provide expertise, oversight, and direction, where small agency management may neither possess nor understand the importance of internal controls nor have the necessary financial management expertise.

Our audits have indicated that in some circumstances these service arrangements are providing no oversight or internal controls for the smaller agency. The service providers are simply processing the paperwork without any managerial review of the transactions. This situation does not improve the Commonwealth's or the smaller agencies' handling of state funds and compliance with applicable state policies and procedures.

In addition, our review of information security in the Commonwealth revealed that most small agencies do not have the resources, expertise, or funding to develop and implement adequate information security programs that protect their critical and sensitive data.

We believe that the Secretaries of Administration, Finance, and Technology should work with the Departments of Accounts, General Services, Planning and Budget, and Human Resource Management, and the Virginia Information Technologies Agency to develop and implement an administrative agreement for all back office operations, including information security, managerial oversight, and internal controls, for agencies requiring administrative assistance or establish a central back office operation to provide these functions. The current arrangements do not provide a cohesive process which addresses the true operations of an administrative unit. For example, purchasing depends on budget availability, understanding of state contracting practices, contract management, and ultimately the payment and recording of the purchase.

We believe that Secretaries need to address the needs of smaller agencies as an arrangement of outsourcing the entire administrative function rather than the paper processing of groups of transactions. We believe that this approach will improve the operational efficiency of these agencies. However, we do not believe that the Commonwealth will recognize any savings in either personnel or cost, since the smaller agencies are using marginal resources with marginal results.

We also recognize that leaders of the smaller agencies will resist this type of change; however, the Commonwealth will greatly improve its internal controls and gain risk management benefits.

## **INTERNAL CONTROL AND COMPLIANCE FINDING AND RECOMMENDATION**

The Virginia Racing Commission has made progress in improving its operations and management has taken a number of actions to address the internal control issues that we reported in the past. However, considering the Commission only employs 7 full-time employees, it may be difficult to train and maintain personnel with the expertise to address the remaining internal control and compliance deficiency and prevent future deficiencies.

Currently, the Commission outsources several of its administrative functions to various agencies within the Commonwealth. However, as noted above in the risk alert and efficiency issue, we do not believe that having multiple agencies providing services to the Commission has significantly improved the efficiency or controls surrounding their operations. We believe the Commission could benefit from participating in an administrative service bureau, by gaining the expertise and continuity of personnel necessary to address internal control and compliance issues such as the issue we note below.

### **Comply with the Commonwealth's Security Standard**

The Commission's information security program does not meet Virginia's Information Technology security standard, ITRM Standard SEC 501. The Commission, like many smaller agencies in the Commonwealth, does not have any information technology staff and relies on the Virginia Information Technologies Agency (VITA) to maintain their internal operating system. Therefore, during fiscal year 2007 the Commission hired a consultant, contracted through VITA, to assist them in bringing their information security program into compliance with the Commonwealth's security standards. The consultant has prepared and provided to the Commission for review documentation for the information security program. However, the Commission has not yet approved the documentation.

In our review of the documentation, we found that the Commission has made progress in addressing our previous recommendations; however, the following components of their security program continue to lack the details necessary to comply with Virginia's Information Technology security standard.

- Security Awareness Training Program;
- Business Impact Analysis;
- Business Continuity Plan that includes information regarding essential business functions or IT systems needed to continue operating in the event of disruptions or ways to minimize the effect of disruptions;
- Incident Response Procedures, and
- Disaster Recovery Plan that includes information to recover from a disaster affecting the network.

In addition, the Commission does not have a detailed Risk Assessment that addresses the potential risks of the Commission and the impact that these risks may have on its operations, which is a required component of a security program.

Without a detailed information security program, the Commission cannot adequately identify or maintain critical IT components (including data) that the Commission relies upon to carry out its business objectives. The Commission should ensure that its procedures include the detail required by the ITRM Standard SEC 501. The Commission must also ensure it has sufficient policies and procedures to govern how VITA and the partnership should protect the Commission's systems.

We also believe that the Commission needs to consider the long-term commitment that maintaining this program will place on the staff and future resources. Technology, information needs, and threats to these resources are an ever changing environment which requires constant update and review. The Commission has contracted with a vendor to manage its information security, but it should also consider evaluating different options available such as partnering with other smaller agencies to collectively manage the group's information systems in accordance with the Commonwealth's standards.

## AGENCY HIGHLIGHTS

The Virginia Racing Commission controls and prescribes regulations and conditions for all horse racing with pari-mutuel wagering privileges in the Commonwealth. It licenses horse racetracks and satellite facilities and ensures that all their employees have valid Commission permits. The Commission also issues permits to anyone associated with horse racing including horse owners, trainers, jockeys, grooms, veterinarians, and blacksmiths. Pari-mutuel horse racing began in the Commonwealth in September 1997 at Colonial Downs, a privately held racetrack in New Kent County. The Code of Virginia permits up to ten satellite wagering facilities. Currently, there are nine satellite facilities operated by Colonial Downs, which are located in Brunswick, Chesapeake (two), Hampton, Martinsville, Richmond (two), Scott, and Vinton. The Commission monitors each of these facilities as a part of its regulatory oversight.

The Code of Virginia directs the distribution of the funds in the horse racing wagering pools. The percentage distribution varies based on factors such as the type of wagering, whether the race took place within or outside of the Commonwealth, and whether the wagering occurred at the racetrack or at a satellite facility. The Commonwealth retains as a license tax a portion of the wagering pools ranging from 0.75 to 2.25 percent as directed by the Code of Virginia. All revenues received by the Commission go to a special fund known as the State Racing Operations Fund. The Appropriation Act requires the Commission to transfer any funds in excess of the Commission's operating expenses to the General Fund of the Commonwealth. However, the Appropriation Act contains language allowing the Commission to carry forward a portion of its unspent appropriation related to the promotion, marketing, sustenance, and growth of the Virginia horse industry as long as it makes its required transfer to the General Fund. At June 30, 2007, the Commission had a cash balance of \$681,006 in its operating fund related mostly to unspent marketing funds. The Commission transferred the amount required by the Appropriation Act to the General Fund during fiscal year 2007.

The Code of Virginia also created the Virginia Breeders Fund to support an incentive program to foster the industry of breeding racehorses in Virginia. It receives a one percent distribution of the horse racing wagering conducted in the Commonwealth. The Commission contracted with the Virginia Thoroughbred Association and the Virginia Harness Horse Association to manage the fund. The incentive program provides purses for races restricted to Virginia bred or sired horses and awards to the owners and breeders of Virginia bred horses that win or earn purse money in races designated by the Commission. During fiscal year 2007, the Commission made payments of \$1,439,797 from the Breeders Fund consisting of \$778,178 in purse money, \$556,619 in incentives to owners and breeders, and \$105,000 in management fees to the Virginia Thoroughbred Association and the Virginia Harness Horse Association. At year-end, the cash balance in the Breeder's Fund was \$968,845. The cash balance does not revert to the General Fund.

Below are the results of the fiscal year 2007 financial operations of the Virginia Racing Commission. The Commission increased its budgeted expenditures in anticipation of additional race days. However, since Colonial Downs did not increase its race days, the Commission spent less than the budgeted amounts for personal services and incentive payments, which are directly related to the number of race days. In addition, there was a change in the timing of the contract payments to the Virginia Thoroughbred Association and the Virginia Harness Horse Association, which contributed to the variance in incentive and marketing payments. These items, coupled with the allowed carry forward for marketing, result in the cash balances in both the Breeders and Operating Funds.

VIRGINIA RACING COMMISSION  
SCHEDULE OF REVENUES, EXPENSES, AND CHANGES  
IN CASH BALANCES - BUDGET AND ACTUAL  
For the year ended June 30, 2007

	Actual				Total Variance
	Total Budget	Breeders Fund	Operating Fund	Total	Positive/ (Negative)
Revenues:					
Taxes and pari-mutuel wagering	\$ 4,850,000	\$ 1,684,063	\$ 3,124,884	\$ 4,808,947	\$ (41,053)
License and permit fees	160,000	-	140,890	140,890	(19,110)
Fines and assessments	15,000	-	9,700	9,700	(5,300)
Interest	60,000	37,601	3,830	41,431	(18,569)
Total revenues	5,085,000	1,721,664	3,279,304	5,000,968	(84,032)
Expenditures:					
Personal services	1,210,209	-	960,340	960,340	249,869
Contractual services	555,454	-	564,510	564,510	(9,056)
Supplies and materials	16,000	-	20,590	20,590	(4,590)
Incentive and marketing payments	3,406,900	1,439,797	466,400	1,906,197	1,500,703
Continuous charges	42,650	-	80,741	80,741	(38,091)
Equipment	21,239	-	869	869	20,370
Total expenditures	5,252,452	1,439,797	2,093,450	3,533,247	1,719,205
Transfers out:					
General fund	815,870	-	816,049	816,049	(179)
Literary fund	15,000	-	9,700	9,700	5,300
Total transfers	830,870	-	825,749	825,749	5,121
Revenues over/(under) expenditures and transfers out	(998,322)	281,867	360,105	641,972	1,640,294
Cash balance at June 30, 2006	1,007,879	686,978	320,901	1,007,879	-
Cash balance at June 30, 2007	\$ 9,557	\$ 968,845	\$ 681,006	\$ 1,649,851	\$ 1,640,294

Source: Commonwealth Accounting and Reporting System





# Commonwealth of Virginia

**Walter J. Kucharski, Auditor**

**Auditor of Public Accounts  
P.O. Box 1295  
Richmond, Virginia 23218**

September 30, 2007

The Honorable Timothy M. Kaine  
Governor of Virginia  
State Capital  
Richmond, Virginia

The Honorable Thomas K. Norment, Jr.  
Chairman, Joint Legislative Audit  
and Review Commission  
General Assembly Building  
Richmond, Virginia

We have audited the financial records and operations of the **Virginia Racing Commission** for the year ended June 30, 2007. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

## Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions on the Commonwealth Accounting and Reporting System, review the adequacy of the Commission's internal controls, test compliance with applicable laws and regulations, and review corrective actions of audit findings from prior year reports.

## Audit Scope and Methodology

The Commission's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

Contractual services expenditures  
Facility inspection process  
Incentive and marketing payments  
License and permit fees

Payroll expenditures  
Small Purchase Charge Card  
Tax and pari-mutuel wagering revenues  
TRAC V System

We performed audit tests to determine whether the Commission's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel and observation of the Commission's operations. We inspected documents including reconciliations, deposit slips and certificates, wagering reports provided by Colonial Downs, revenue summary reports, contracts, and off-track satellite facility review sheets. We reviewed the Commission's policies and procedures and Board Minutes and appropriate sections of the Code of Virginia and the 2007 Virginia Acts of Assembly. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

### Conclusions

We found that the Commission properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Commission records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting.

We noted a matter involving internal control and its operation and compliance with applicable laws and regulations that requires management's attention and corrective action. This matter is described in the section entitled "Internal Control and Compliance Finding and Recommendation."

### EXIT CONFERENCE AND REPORT DISTRIBUTION

We discussed this report with management on October 10, 2007. Management's response has been included at the end of this report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

SAH:clj



# COMMONWEALTH of VIRGINIA

## *Virginia Racing Commission*

*10700 Horsemen's Road  
New Kent, Virginia 23124  
(804) 966-7400; FAX (804) 966-7418*

October 19, 2007

Walter J. Kucharski  
Auditor of Public Accounts  
101 North 14<sup>th</sup> Street, 8<sup>th</sup> Floor  
Richmond, VA 23219

Dear Mr. Kucharski:

On behalf of the Virginia Racing Commission and in my capacity as Executive Secretary, I have reviewed the findings and recommendations provided by your office in this report for the period July 1, 2006-June 30, 2007, and offer the following comments:

1. As stated in your report the Commission's information security program still lacks some of the components necessary to comply with the Commonwealth's security standard. We have been working with VITA and a consultant to develop the policies and procedures to comply with the standards set by VITA. Work is still in progress and we believe all required information and reports will be updated and completed by the end of 2007.
2. The Commission is an agency of seven employees all specialists in the regulation of pari-mutuel racing and wagering in the Commonwealth. The Commission does not have sufficient expertise, resources or staff to handle human resources, payroll administration, processing and paying invoices, internal controls and information technology. As a result, most of those responsibilities are outsourced to several other agencies. The suggestion that a single back office be established to perform those services for small agencies has considerable merit and would result in a better coordinated effort in meeting state guidelines.

Thank you for the opportunity to respond to your report.

Sincerely,

*Stanley K. Bowker*  
Stanley K. Bowker  
Executive Secretary

VIRGINIA RACING COMMISSION

Peter C. Burnett  
Chairman

Mark T. Brown	I. Clinton Miller
William (Trip) H. Ferguson	David C. Reynolds

Stanley K. Bowker  
Executive Secretary

